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SUBJECT: Economic Slump Takes the Wind Out of Shipping Industry's Sails in South China

REF: A) Beijing 4679, B) Guangzhou 715, C) Guangzhou 668, D) Guangzhou 618, E) Guangzhou 228

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¶1. (U) SUMMARY: There's no hiding from the numbers: the shipping industry in south China is suffering and they have little choice but to continue aggressively cutting costs to deal with the impact of the economic downturn. South China's ports appear to have been hit harder than those in other regions, further reinforcing pessimistic predictions by local manufacturing industry leaders that 2009 will likely witness more of the same. Shipping companies, already operating on low profit margins, are being squeezed as ocean freight prices on some routes have dropped by as much as 80 percent. Industry sources say the slowdown is primarily driven by deteriorating overseas demand, but exacerbated by other factors such as excess capacity in shipping vessels and changing conditions in south China's manufacturing-based economy - especially rising wages and raw material costs - and appreciation of China's currency. End summary.

Port Traffic Slows, Falling Rates Squeeze Companies

¶2. (SBU) South China's port and shipping industry have seen a sharp drop in business during the last quarter of 2008, according to Cai Jinlong, Vice President of Guangzhou Port Group (GZP), reflecting comments similar to those reported ref A. After registering strong growth during the first six months of the year, total port traffic fell year-on-year in August and September and recovered with only modest growth in October and November. Shenzhen, which relies more heavily on foreign trade, has been especially hard hit, with total port volume in November down by 12.3 percent year-on-year, according to Ministry of Transportation statistics. Cai also pointed out that Hong Kong's container traffic had declined by 13.9 percent in October. Comment: In contrast, other major ports in Asia, including some elsewhere in China, appear to have suffered less (ref A) - suggesting south China's export sector is being hit particularly hard by deteriorating overseas demand. This further reinforces the gloomy predictions we've heard from manufacturing industry leaders in the Pearl River Delta (refs B and C). End comment.

¶3. (SBU) Also troubling are the falling shipping rates squeezing

companies' profitability, said Danny C.K. Ng, Regional Manager of Hanjin Shipping's south China operations. According to Ng, several shipping companies, attempting to establish large market share earlier this year, leased or purchased additional vessels leading to overcapacity throughout the industry and, in turn and inevitably, a gradual decline in shipping rates per twenty-foot equivalent (TEU) containers. Once the financial crisis hit in September, he said, the price decline went into free fall as customers cancelled orders, and shipping rates for the China-Europe route fell 80 percent, from USD 1,000 per container to its current USD 200 level - a difficult situation for companies operating on already low profit margins, lamented Ng. (Comment: There is a bright side to this, as Nine Dragons CEO Zhang Yen told the Consul General over dinner one evening; those whose import-related businesses are good or quickly recovering from the downturn are able to negotiate and factor in major price concessions from shipping companies in their budget calculations. End Comment.)

¶4. (SBU) As cold comfort, Ng pointed out that Hanjin's China-U.S. route's shipping rates have "only" fallen 25-30 percent; not because U.S. demand is buoyant, but because in the U.S., carriers and customers negotiate annually and lock in rates for one year. Most of these contracts are set to expire by May 2009, according to Ng, and then there will likely be some additional headaches for the companies which will have little leverage in negotiations.

Impact of Low Demand and Low Fuel Prices

¶5. (U) Both Hanjin and GZP executives said the worsening business climate is primarily due to deteriorating demand from overseas but

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also pointed to other factors that have gradually eroded the competitiveness of south China's exports. These include the widely reported impact of rising wages, raw material costs and appreciation of China's currency (refs D and E).

¶6. (SBU) GZP executives described the recent decrease in oil prices as an "opportunity" for more port business. Unlike Hong Kong and Shenzhen, a large portion of Guangzhou's port traffic is exporting coal and importing oil, said Cai. The sudden reprieve from high oil prices not only lowers operating costs, but also increases port traffic by incentivizing oil traders to import and "hoard" oil while prices are low.

¶7. (SBU) Hanjin's Ng said lower oil prices have indirectly softened the impact for shipping companies by reducing costs for their customers. But he pointed out that carriers already had a built in hedging mechanism in the form of a customer surcharge - Bulk Utilization Charges (BUC) - which is based on fluctuating oil prices and is adjusted on a monthly basis.

Coping with Crisis by Trimming the Sails

¶8. (U) Shipping companies are cutting costs in order to square operating capacity with shrinking global demand. Neither GZP nor Hanjin Shipping envision "wide-spread" bankruptcies in the industry, but say most companies will aggressively cut costs. According to media reports, Danish shipping giant Maersk Line, the largest in the world, announced in October that it would close its Guangdong Information Processing Center and gradually lay off more than 700 employees in the first half of 2009. Other shipping companies in the region are choosing not to renew contracts on leased vessels, hoping to reduce excess capacity, according to Ng. He also expects to see many more partnerships forming between companies during 2009 in order to share ocean surface routes to reduce costs.

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